

The Board of Appeals administers a voluntary disclosure program that provides for limited liabilities for participants who come forward and disclose their tax liabilities. See 86 Ill. Adm. Code 210.126. (This is a GIL)

August 11, 2008

Dear Xxxxx:

This letter is in response to your letter dated March 1, 2008, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This letter is in reference to our Client's (the 'Taxpayer') desire to settle an Illinois sales/use tax liability. For your consideration, we respectfully submit the following statement of facts and proposed solution.

Facts

The Taxpayer specializes in the design, manufacture, and marketing of medical devices for implant. The Taxpayer solicits orders through independent representatives that canvas doctors offices and hospitals in the region where he/she lives. The Taxpayer charges the independent representatives a rental fee for 'installation kits' that are used for installation of the implant into the patient. In January, 2007, the Taxpayer's operational personnel started implementing a new rental program whereby the rental fees charged for installation kits would change from a varying percentage of the kit's value to a fixed percentage. In September, 2007, the program was fully implemented and the corporate tax department was notified that all rental charges for 2007 would reflect the new fixed percentage. This created an underpayment of sales taxes for the period from January 1, 2007 through August 31, 2007.

The Taxpayer is headquartered in the state of STATE1 and incorporated under the laws of the state of STATE2. The Taxpayer has been doing business in Illinois for several

years and is registered for all applicable state and local taxes. The Taxpayer has not been contacted by the State of Illinois regarding the underreported sales taxes due. The Taxpayer strives to comply with the laws of Illinois and has not willfully or intentionally sought to avoid Illinois's sales tax.

The Taxpayer wants to be proactive and settle their obligations with the State. However, the Taxpayer is concerned that by coming forward, the State may impose penalties or conduct an audit of the Taxpayer. After discussing this matter with our Firm, we recommended that the Taxpayer pursue a voluntary disclosure agreement with the State. Acting on our advice, the Taxpayer respectfully submits the following proposal, to wit.

Proposed Agreement

Whereas, the Taxpayer has recently been made aware of an outstanding Illinois sales/use tax liability;

Whereas, the Taxpayer has not willfully or intentionally sought to avoid payment of Illinois's sales/use tax;

Whereas, the Taxpayer is not now under audit or investigation by the State, and,

Whereas, the parties to this agreement recognize the potential hazards of any resulting audit, assessment, or litigation, and acknowledge that this agreement will compromise and settle the Taxpayer's liabilities because it is mutually beneficial to the State and the taxpayer;

Now therefore, the State and the Taxpayer, in consideration of the premises agree as follows:

- The Taxpayer agrees to remit delinquent Illinois sales taxes, plus interest, for returns that were due for the period January 1, 2007, through August 31, 2007;
- The Taxpayer will perform a self audit and determine the exact amount taxes due to the State, and will provide the State with schedules supporting the calculation no later than ninety days after the execution of this agreement;
- The Taxpayer will remit the delinquent taxes, plus interest, no later than ninety days after the execution of this agreement;
- The State will not impose any civil or criminal penalties or conduct an audit of the Taxpayer related to this agreement. The State reserves the right to audit and assess sales/use taxes if the Taxpayer has misrepresented the facts to the State;
- The Taxpayer will maintain its registration for sales/use tax and has or will timely file such returns from September 1, 2007 forward;
- Upon receipt of this proposal, the State will issue a case number to the Taxpayer and will continue to negotiate this matter with the Taxpayer, even if the Taxpayer is subsequently contacted by the State regarding this matter.

We trust this proposal will be acceptable to the State and appreciate your cooperation in this matter. On behalf of the Taxpayer, we look forward to resolving this matter promptly and maintaining good standing with the State. If you have any questions, please do not hesitate to contact me.

DEPARTMENT'S RESPONSE:

The Board of Appeals administers a voluntary disclosure program that provides for limited liabilities for participants who come forward and disclose their tax liabilities. The details of this program are set out in 86 Ill. Adm. Code 210.126. The regulation and the Department's form BOA-2, "Application for Voluntary Disclosure," are available on the Department's website.

You have indicated that your client has changed the amount of its rental fees and that this created an underpayment of sales tax. Please be aware that the State of Illinois treats leases differently than the majority of other states. In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts, and the lessees incur no Use Tax liability for the rental charges. In Illinois, a true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

As mentioned, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3).

Even though lessees do not incur any tax liability in a true lease situation, it is typical of true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to satisfy that duty because of a contractual agreement, not because of Illinois tax law.

As stated above, the State of Illinois imposes no Retailers' Occupation Tax or Use Tax on rental receipts. Moreover, since a lessee under a true lease incurs no tax liability on the lease of tangible personal property, the lessee generally incurs no such tax liability on any related lease charges such as late payment fees, disposition fees, lease termination fees, service fees, or legal fees.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Richard S. Wolters
Associate Counsel

RSW:msk